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Research on the Tax Burden of Chinese Insurance Companies After Replacing the Business Tax with a Value-added Tax

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Abstract

The tax burden has long existed in the course of collecting the insurance industry tax. What's more, the unreasonable taxation structure, etc. seriously restrict its development. Therefore, the promotion of replacing the business tax with a value-added tax (hereinafter referred to as BT to VAT) is an inevitable requirement to boost the internal construction and regulate turnover tax regime. Property insurance, as one of the primary services of insurance companies is able to profoundly reflect the influences brought by the policy of BT to VAT. This paper begins with the state of our country, while referring to the experiences of international tax system reform. What's more, it takes PICC as an example, aiming to compare the tax burden before and after the implementation of BT to VAT as well as put forward logical recommendations.

Key words: BT to VAT; Insurance industry; International experience; PICC

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INTRODUCTION

The business tax and the value-added tax (VAT) are two extremely important turnover taxes in the existing tax system in China, both in parallel for a long time. Subject to the constant development of the economy, the disadvantages of the tax system structure gradually come

out, which is not only conducive to the prosperity of the industry, but also causes a huge risk in the collection process. Therefore, approved by the State Council, the Program on Reform Pilot of Replacing the Business Tax with a Value-added Tax (hereinafter referred to as BT to VAT) was issued jointly by the Ministry of Finance and the State Administration of Taxation in 2011. Several pilots of BT to VAT have been implemented in Shanghai transportation industry and some modern service industries since January 1, 2012, which indicates the beginning of the reform of the tax system for goods and services. From August 1, 2012 to the end of 2012, the State Council had expanded the pilots of BT to VAT to 10 provinces and cities, and Beijing would become one of them in September. As of August 1, 2013, the scope of "BT to VAT" had been extended to the whole country, which was irreversible.

Subject to the continuous implementation, "BT to VAT" is imperative in the financial industry. As an important part of the financial industry, the modern insurance industry will become the first to be affected by the impact of the reform. Focusing on the practical tax system of China's insurance industry, based on the long-term development of the insurance industry, this paper draws on the international experience in tax reform, and the predictive analysis has been made for the influence on insurance industry from "BT to VAT". In addition, proposals have been put forward for the insurance industry to deal with the reform.

1. THE REALISTIC MEANING OF IMPLEMENTING BT TO VAT IN CHINESE INSURANCE INDUSTRY

1.1 Existing Problems in Chinese Insurance Industry

1.1.1 Excessive Tax Burden

The business tax of insurance industry in China is excessive. The following reason can account for the

phenomena: Firstly, its tax rate is high. Insurance operation is a kind of special activity which may have liabilities with big risks. Therefore, a high rate of tax is not recommended. In developed countries, the rate of business tax is always lower than 3%. Secondly, its tax base setting is not reasonable which does not exclude relevant fees from business turnover.

1.1.2 Unreasonable Taxation Structure

The business tax of Chinese insurance industry adopts rigid uniformity with excessive tax rate and uniformed rate; besides, the tax base is unreasonable which does not exclude relevant fees from business turnover. At present, parts of life insurance business services are exempted from business tax, which mainly refer to those over one year warranty period (not including one year), such as ordinary life insurance, old-age pension insurance, health insurance etc. that should return for principle expired. However, it can be rarely seen that the business tax of property-casualty insurance companies are exempted. Judging from the whole industry, the tax base is broad and the whole tax burden is high. Property & casualty companies run a dazzling array of non-life insurance services which are complicated and are easily affected by natural disasters and catastrophes. By the way, they all belong to short-term insurances. Internationally, there is an obviously individualized taxation policy in terms of insurance industry especially the non-life insurance services. Furthermore, different tax rates and bases are defined toward different insurances, which are research emphases of this paper.

1.2 Promoting BT to VAT to Stimulate the Development of Insurance Industry

1.2.1 Necessities

In financial industry, it goes against the legislative spirit of generally collecting value-added tax if traditional sales tax (collect full tax of commodity turnover) is adopted rather than value-added tax because value-added tax is a kind of tax which firstly realizes the tax integration of goods and services; what's more, selective collection of value-added tax will cause a twist effect on economical operation because business tax included in output value which is produced by the financial industry investing on other industries cannot be exempted. In addition, the value-added tax of purchasing goods cannot be exempted either. The value-added tax deduction chain cannot be extended because it will cause the increase of tax compliance cost throughout the society. Furthermore, it will force the merger and consolidation in industries or companies for the purpose of tax and violate the tax neutrality principle.

1.2.2 Feasibilities

Value-added tax was introduced to China in 1979 which was firstly adopted in the modern industrial production links of outshining machinery industry and was accordingly adopted by almost all industries except for

business tax projects. In January 2012, Shanghai started to launch the reform of BT to VAT, which extended to 10 provinces or cities since August, which are Beijing, Tianjin, Jiangsu, Zhejiang, Anhui, Fujian, Hubei, Guangdong, Xiamen and Shenzhen. Since 1st January 2014, BT to VAT enlarged its scope, railroad transportation and postal services were also included into the reform. Even though, the tax of finance and insurance industry is the most difficult one to reform with complicated tax rates and less international experience to refer to. A glittering array of scholars beckon that the collection of VAT is a difficult issue in the international area at present. The perfection of taxation policy is imperative in order to push the global strategy in terms of insurance industry and be adapted to the long-term development of global insurance industry. Concerning financial institutions, they are productive service departments with a high level of informatization and sound internal control system. Comparing to other service industries, financial industry has advantages in terms of inner power and external conditions.

It will be seen from this that BT to VAT will become an inevitable trend, which has demerits in the executing process because of the unique economic characteristics in China.

2. INTERNATIONAL REFERENCE AND INSTITUTIONAL DESIGN OF TAXATION MODEL IN CHINESE INSURANCE INDUSTRY

The reform of business tax plays a vital role in the development of insurance companies, which is not confined to the adjustment of tax rate but highlights the adjustment of taxation structure. In addition, it should take the special conditions of China into consideration, which cannot be rashly conducted. As far as I am concerned, tertiary industry in developed countries is at a high development level with rich tax reform experience. Therefore, we may refer to the advanced international experience to optimize business tax reform.

2.1 International References

At present, life insurance business and non-life insurance business are excluded from VAT in many countries. Only a few countries collect VAT on non-life insurance business, showing in Table 1. After going through a period when VAT in insurance industry is free of charge, many countries recollect tax on property insurance, and short-term insurance. Some researches and opinions of European Union demonstrate practical problems as well as difficulties in collecting VAT, which to some extent reflect the opinions of Allen A. Tate. In ALLEN's opinion, it is a reasonable choice to collect tax when the VAT chain collapses and economy develops to a certain

level regardless of some unreasonable matters. Judging from the countries and regions implementing value added system, there are three taxation models in terms of insurance business: Firstly, core business: simplified tax

or income tax countervail; secondly subsidiary business collecting tax based on standard tax rate; thirdly export business conducting zero tax rate.

Table 1
The Insurance Services Which are Exempted from VAT in some Developed Countries or Regions

| Countries or regions | European Union | Canada | Australia | New Zealand | Singapore | South Africa | Japan |
|----------------------|----------------|----------|-----------|-------------|-----------|--------------|----------|
| Life insurance | Tax-Free | Tax-Free | Tax-Free | Tax-Free | Tax-Free | Tax-Free | Tax-Free |
| Non-life insurance | Tax-Free | Tax-Free | Taxable | Taxable | Taxable | Taxable | Tax-Free |

Note. Data sources: Proposed Introduction of VAT for the Insurance in China | KPMG | CN

2.2 Institutional Design

To life insurance business, most services are tax-free in China. Internationally, countries or regions collecting business tax or VAT do not collect tax on life insurance business. According to the spirit and changes of insurance enterprises accounting system in Meeting Minutes of Researching on Relevant Problems after the Launching of Reforms of Fiscal and Taxation Systems (National reading panel [1994] No.42), health insurances such as ordinary life insurance, old-age pension insurance, health insurance etc. which should return for principle expired over one year (including one year) should be exempted from tax. Therefore, while conducting research we can separate property insurance to elaborate the effect of BT to VAT on insurance companies. This paper aims to analyze the core business of property-casualty insurance companies without taking subsidiary business into consideration, which takes premium income and total indemnity expenditure as research objectives. By the way, it will also carry out tax calculation of BT to VAT based on the current VAT collection policies.

which are life insurance companies and property insurance companies. Property insurance companies are engaged in non-life insurance products which can be called non-life insurance companies. So, judging from enterprises, they are equal. This paper takes PICC as an example to analyze the effect of BT to VAT on property-casualty insurance companies in details.

People's Property & Insurance Company of China, which can be called P&C, PICC and property insurance originating from People's Insurance Company of China, was established in 1949. It belongs to large state-owned financial enterprise, and experienced shareholding reform in 2002, which is then divided into People's Insurance Co. of China and China Life Insurance Company Limited. It was listed on the Hong Kong stock market in 6th November 2003 and is the largest non-life insurance company in mainland China at present. It mainly provides various property-casualty insurance products for clients. By the way, it takes lead in the non-life insurance market and leads the development of non-life insurance market. Property insurance, accident insurance, and short-term health insurance are primary services it offers. In terms of centralized business such as large-scale commercial risks, government procurement and blanket insurance as well as decentralized business such as vehicle insurance and homeowner insurance, it definitely takes the leading position.

Countries which collect VAT on non-life insurance business always adopt general tax means and the computing formula shows as follows: $VAT = (\text{premium income} - \text{insurance proceeds which have been paid}) \times \text{VAT rate}$. While referring to the levying tax means of developed countries, OECD members confirm the value tax's added income tax countervail based on a fixed ratio of premium income. It is not reasonable to regard premium income as the tax base, so this paper takes earned premium as output tax to collect VAT. VAT rate has its basic tax rate, standard rate and reduced rate. This paper selects 17% of the basic tax rate to carry out estimation.

3. CHANGES AND ANALYSIS OF TAX BURDEN IN TERMS OF BT TO VAT OF PROPERTY-CASUALTY INSURANCE COMPANIES

There are various duty-free services because of the current business tax system but few duty-free tax projects in non-life insurance business. Besides, many developed countries do not collect VAT on life insurance business but collect tax on non-life insurance business. Put all of these factors together, this paper mainly analyzes the effect of BT to VAT on property-casualty insurance companies. From the perspective of enterprises, there are two categories in Chinese commercial insurance companies

3.1 Analysis on the Overall Change of PICC's Tax Burden

Table 2
Part of the Detail List of PICC's Business Performance

| | 2013 | 2012 | 2011 | 2010 | 2009 |
|----------------|--------|--------|--------|--------|--------|
| Turnover | 223525 | 193487 | 173962 | 154307 | 119771 |
| Earned premium | 182546 | 155304 | 96877 | 122990 | 93296 |

Unit: million yuan

To be continued

Continued

| | 2013 | 2012 | 2011 | 2010 | 2009 |
|--|----------|----------|---------|---------|---------|
| Compensation expenses | (133197) | (109170) | (84277) | (76389) | (71811) |
| Compensation payout refund | 18249 | 17070 | 7790 | 8910 | 13283 |
| Allotment of reserves for outstanding claims | (7996) | (7796) | (472) | (14908) | (7531) |
| The recovered reinsurance compensation cost | 2043 | 1173 | 2809 | 522 | 1542 |
| Expenditures dividend policy | (0.7) | (5) | (17) | (25) | (112) |
| Reinsurance expenses | (107) | (95) | (79) | (70) | (75) |
| Amortized reinsurance expenditures | 11356 | 10120 | 12861 | 5559 | 3466 |
| Service fee expense | (19011) | (17025) | (14661) | (13940) | (12095) |
| Business tariff and annex | (11066) | (9820) | (8948) | (8015) | (6160) |

Note. Data resource: annual report of PICC. <http://piccnet.com.cn/cn/tzz/yjgg/index.shtml>

Table 2 is part of partial data of PICC'S business performance from 2009 to 2013. After arrangement, the data is used to calculate the tax, relevant urban maintenance, construction tax and educational surcharge after conducting BT to VAT. Besides, comparison between tax forecasting and original sales tax as well as additional sales tax is carried out, and the concrete computational process shows as follows:

Value added tax payable = premium difference × VAT rate
Urban maintenance and construction tax = value added tax payable × tax rate
Education surcharge = value added tax payable × tax rate
Tax = value added tax payable + urban maintenance and construction tax and educational surcharge

Tax rate of change = (total amount - business tariff and annex) / business tariff and annex
among which

Premium difference = premium income - a fixed premium
Premium income = earned premium

A fixed premium = Compensation expenses - compensation payout refund + Allotment of reserves for outstanding claims - the recovered reinsurance compensation cost + expenditures dividend policy + reinsurance expenses - amortized reinsurance expenditures + service fee expense

VAT rate is 17%, and Urban Maintenance and Construction Tax is 7%, extra charges of education funds rate is 3%. After calculation we can know the general table of tax burden after conducting BT to VAT.

Table 3
General Table of Tax Burden After Conducting BT to VAT

Unit: million yuan

| | 2013 | 2012 | 2011 | 2010 | 2009 |
|--|--------|---------|---------|---------|---------|
| Business tariff and annex | 11066 | 9820 | 8948 | 8015 | 6160 |
| Value added tax payable | 9160 | 8029 | 3541 | 5550 | 3394 |
| Urban maintenance and construction tax | 641 | 562 | 248 | 389 | 238 |
| Education Surcharge | 275 | 241 | 106 | 167 | 102 |
| Variation of tax burden | (990) | (988) | (5053) | (1910) | (2427) |
| Change rate of tax burden | -8.95% | -10.06% | -56.47% | -23.83% | -39.40% |

Judging from Table 3, we can know that the rate of business tax is 5% which turns to 17% after the reform. Superficially, the ratio has increased a lot. However, if business tax is collected with a 17% rate after BT to VAT, the tax burden from 2009 to 2013 will decrease because the tax base is different. Averagely, it will decrease 27.74% and shall be up to 56% in 2011. At present, there are few policies which enable insurance business to be exempted from tax. While calculating VAT, tax-

free factors are not taken into consideration so the above results shall have strong comparability.

3.2 Analysis on the Change of Tax Burden of Different Insurance Businesses

Primary services of PICC include motor vehicle insurance, business property insurance, freight insurance, liability insurance, accidental injury insurance and health insurance.

Table 4
Turnover of Different Insurance Types

Unit: million yuan

| | 2013 | 2012 | 2011 | 2010 | 2009 |
|-----------------------------|---------|--------|--------|--------|-------|
| Motor vehicle insurance | 163,276 | 141755 | 128032 | 115759 | 85529 |
| Business property insurance | 12,581 | 12256 | 11828 | 10570 | 9491 |
| Freight insurance | 3,664 | 3838 | 4044 | 3419 | 2754 |

To be continued

Continued

| | 2013 | 2012 | 2011 | 2010 | 2009 |
|-----------------------------|--------|--------|--------|--------|--------|
| Liability insurance, | 8,446 | 7364 | 6440 | 5442 | 4656 |
| Accidental injury insurance | 9,934 | 6484 | 5343 | 4192 | 3886 |
| Others | 25,624 | 21790 | 18275 | 14925 | 13455 |
| Total | 223525 | 193487 | 173962 | 154307 | 119771 |

Note. Data resource: Annual report of PICC. <http://piccnet.com.cn/cn/tzz/yjgg/index.shtml>

Table 4 is about the turnover data of PICC from 2009 to 2013 based on different insurances. I calculate the turnover proportion of different insurances occupying total volume and then apportion the tax variation and tax rate to each insurance type:

Proportion of each insurance = turnover of each

insurance / total turnover

Tax variation of each insurance = proportion of each insurance + tax variation

Change rate of each insurance = proportion of each insurance * change rate of tax

After calculation, we can get Table 5 and 6.

Table 5
Variation of Different Insurance

Unit: million yuan

| | 2013 | 2012 | 2011 | 2010 | 2009 |
|-----------------------------|-------|-------|--------|--------|--------|
| Motor vehicle insurance | (723) | (724) | (3719) | (1433) | (1733) |
| Business property insurance | (56) | (63) | (344) | (131) | (192) |
| Freight insurance | (16) | (20) | (117) | (42) | (56) |
| Liability insurance | (37) | (38) | (187) | (67) | (94) |
| Accidental injury insurance | (44) | (33) | (155) | (52) | (79) |

Table 5 and Table 6 is the change of different insurances' tax burden from 2009 to 2013. Judging from the tax cuts, motor vehicle insurance business dominates in terms of average turnover and the tax decreases 1666 million Yuan in five years with an average cut tax ratio 20%. The minimum is freight insurance which decreases 50 million Yuan with an average cut tax ratio 0.62%. If the 17% VAT ratio is adopted after conducting BT to VAT without taking other preferential policies into consideration, it shall make a big difference. Even though

the scheme of BT to VAT puts forward that insurance industry is adapted to simplified tax, which does not have a distinguished difference from business tax in principle. Comparatively speaking, it is a temporary solution and we can temporarily introduce non-life insurance to the reform of VAT system. But in a long run, we have to refer to the international experience and set reasonable VAT collecting system, especially focusing on the setting of tax rate and tax base which are suitable for China.

Table 6
Tax Changes of Different Insurances

Unit: million yuan

| | 2013 | 2012 | 2011 | 2010 | 2009 |
|-----------------------------|--------|--------|---------|---------|---------|
| Motor vehicle insurance | -6.53% | -7.37% | -41.56% | -17.88% | -28.14% |
| Business property insurance | -0.50% | -0.64% | -3.84% | -1.63% | -3.12% |
| Freight insurance | -0.15% | -0.20% | -1.31% | -0.53% | -0.91% |
| Liability insurance | -0.34% | -0.38% | -2.09% | -0.84% | -1.53% |
| Accidental injury insurance | -0.40% | -0.34% | -1.73% | -0.65% | -1.28% |

CONCLUSIONS AND SUGGESTIONS

To conclude, collecting VAT on insurance industry will make up for business tax to some extent, which is able to solve the problem of structural tax reduction and better play the fair principle of tax. However, there are various obstacles we have to deal with in the course of reform. Besides, there may be some contradictory places. Therefore, we should refer to foreign experience, try unremitting efforts to optimize the taxation structure of Chinese insurance industry, and promote the industry development so as to lead to the blossoming of the whole financial industry.

As property & insurance companies, we can start with the following aspects in order to better deal with the effect brought by BT to VAT.

(1) Start with Organizational Structure and Message System to be Adapted to the Requirement of BT to VAT

Property & insurance companies have to begin with organizational structure and message system while facing tax system after conducting BT to VAT so as to adjust the organizational structure. Based on the VAT level of subsidiaries and branch offices, we can realize the sales tax deduction according to the organizational structure

adjustment and construct an optimal transactional model in terms of cost, profits and investment so as to avoid taxes of too many levels.

(2) Adjust the Enterprise Operation and Management Mode

After the reform of VAT, property & insurance companies have to consider the investment of different regions, main bodies and time to realize the optimal profits and taxes. In terms of business process, fund settlement and invoice issuing, we have to fully think about the requirement of VAT in order to avoid paying additional taxes.

(3) Adjust Accounting Method and Taxation Management

What's more, the operation means, business modes, organizational structures and information systems must be adjusted. Under such circumstances, accounting method and taxation management will also be adjusted which will bring along with new financial accounting solutions. In particular, tax-involved risk will greatly increase when taxpayers become VAT taxpayers. So the accounting method and taxation management should

be highlighted and new models should be set up, which include accounting process, taxation process and taxation duties, aiming to better link financial accounting, service information and tax payment to effectively decrease tax burden and task-involved risks.

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